

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 SPC-03 AID-20 EB-11 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

COME-00 FRB-02 INR-10 NSAE-00 XMB-07 OPIC-12 LAB-06

SIL-01 DODE-00 PM-07 H-03 L-03 PA-04 PRS-01 USIA-15

INT-08 FEA-02 SCI-06 TAR-02 IO-14 DRC-01 /216 W

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R 262132Z MAR 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 9059

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY THE HAGUE

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

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DEPARTMENT ALSO PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN, UK

SUBJECT: INTERNATIONAL ASPECTS OF CHANCELLOR HEALEY'S
BUDGET SPEECH

SUMMARY: DURING BUDGET SPEECH, CHANCELLOR ANNOUNCED THAT
INTERNATIONAL LOAN OF \$2.5 BILLION HAS BEEN ARRANGED;
SWAP FACILITIES BETWEEN THE BANK OF ENGLAND AND THE
FEDERAL RESERVE HAVE BEEN INCREASED BY \$1 BILLION TO \$3
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BILLION; EXCHANGE CONTROL RESTRICTIONS ARE TIGHTENED SO

THAT SAME TOUGHER RULES ON OUTFLOW OF INVESTMENT THAT NOW APPLY TO NON-EC, NON-STERLING AREA COUNTRIES WILL ALSO APPLY TO EC AND STERLING AREA MEMBERS AS WELL.
END SUMMARY.

1. IN HIS OPENING COMMENTS ON U.K. ECONOMY, HEALEY REFERRED TO THE PROBLEMS HE INHERITED FROM PREVIOUS GOVERNMENT, WHICH INCLUDED DETERIORATING BALANCE OF TRADE AND LARGE NON-OIL DEFICIT. HE CITED TRADE FIGURES FOR JANUARY-FEBRUARY WHICH SHOW TRADE DEFICIT OF 800 MILLION POUNDS (OF WHICH 430 MILLION POUNDS WAS IN FEBRUARY). AS A RESULT OF THREE-DAY WEEK, EXTRA IMPORTS TOOK THE PLACE OF GOODS NOT AVAILABLE IN BRITAIN WHICH HELPED PRODUCE THE DEFICIT; EFFECTS OF THE THREE-DAY WEEK WILL CONTINUE TO DAMAGE TRADE FIGURES FOR SOME TIME TO COME. OIL PRICE INCREASES WILL ALSO ADD AN ADDITIONAL 2 BILLION POUNDS TO THE U.K. IMPORT BILL THIS YEAR.

2. HEALEY ANNOUNCED THAT THE BANK OF ENGLAND AND THE CLEARING BANKS HAVE ARRANGED FOR A 2-1/2 BILLION DOLLAR LOAN WITH TEN-YEAR MATURITY. HEALEY CALLED THIS LARGEST LOAN EVER RAISED IN INTERNATIONAL CAPITAL MARKETS (HE DID NOT GIVE MORE SPECIFIC DETAILS OF TERMS, SPREADS, ETC. IN HIS SPEECH). IN ADDITION, THE BANK OF ENGLAND AND THE NEW YORK FED HAVE AGREED TO INCREASE SWAP ARRANGEMENTS BY \$1 BILLION, TO \$3 BILLION. BORROWING WAS MORE SENSIBLE IN ECONOMIC AND HUMAN TERMS THAN TRYING TO CUT IMPORTS BY MASSIVE DEFLATION. HOWEVER, INTEREST PAYMENTS WILL EAT INTO U.K. SURPLUS ON CURRENT ACCOUNT.

3. HEALEY SAID HE DID NOT WANT TO USE DIRECT RESTRICTIONS ON IMPORTS IF THIS CAN BE AVOIDED (NO RESTRICTIONS WERE ANNOUNCED). HE SAID THESE WOULD NOT BE IN THE INTEREST OF THE WORLD ECONOMY AND WOULD INVITE RETALIATION. IN ADDITION, IMPORT RESTRICTIONS WOULD NEED TO BE ACCOMPANIED BY OTHER MEASURES TO REDUCE HOME DEMAND, OTHERWISE PLACE OF IMPORTS MIGHT BE FILLED BY GOODS PRODUCED AT HOME WHICH COULD OTHERWISE
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HAVE BEEN EXPORTED.

4. HEALEY ANNOUNCED TIGHTENING OF EXCHANGE CONTROL MEASURES IN FOUR AREAS.

A. FOR DIRECT INVESTMENT IN EC, INSTEAD OF CURRENT RATION OF ONE MILLION POUNDS PER PROJECT PER YEAR AT OFFICIAL RATES OF EXCHANGE (RATHER THAN THROUGH

INVESTMENT DOLLAR MARKET OR OVERSEAS BORROWING), SUCH
INVESTMENT WILL HENCEFORTH BE CARRIED OUT WITHOUT
OFFICIAL EXCHANGE BEING SUPPLIED, IN EFFECT ON SAME
TERMS THAT APPLY TO NON-STERLING AREA. THIS MEANS MOST
NEW OVERSEAS DIRECT INVESTMENT WILL BE FINANCED WITH
INVESTMENT CURRENCY OR FOREIGN CURRENCY BORROWING.
OFFICIAL EXCHANGE WILL ONLY BE AVAILABLE IF THE INVEST-
MENT PROMISES LARGE AND RAPID BENEFITS TO THE U.K.
BALANCE OF PAYMENTS. HOPED FOR BALANCE OF PAYMENTS
SAVING IS 150 TO 200 MILLION POUNDS IN A FULL YEAR. EC
COUNTRIES WERE INFORMED IN ADVANCE. ALONG SAME LINES,
RULES HAVE BEEN CHANGED ON PROVISION OF OFFICIAL EXCHANGE

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INFO OCT-01 EA-11 ISO-00 SPC-03 AID-20 EB-11 NSC-07 RSC-01

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SIL-01 DODE-00 PM-07 H-03 L-03 PA-04 PRS-01 USIA-15

INT-08 FEA-02 SCI-06 TAR-02 IO-14 DRC-01 /216 W

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R 262132Z MAR 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 9060

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

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FOR DIRECT INVESTMENT IN OVERSEAS STERLING AREA, PUTTING IT ON EQUAL FOOTING WITH NON-STERLING AREA AND EC. HOPED FOR SAVING IS 50 MILLION POUNDS A YEAR.

B. THERE IS A PROVISION THAT PORTFOLIO INVESTORS SELLING SECURITIES DENOMINATED IN NON-STERLING AREA CURRENCIES MUST SURRENDER 25 PERCENT OF FOREIGN EXCHANGE PROCEEDS IN THE OFFICIAL MARKET. THIS HAS NOW BEEN EXTENDED TO PROCEEDS FROM SALE OF OVERSEAS STERLING AREA SECURITIES. NO ESTIMATE ON SAVINGS.

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C. UNTIL NOW, PROCEEDS OF DIRECT DISINVESTMENT IN NON-STERLING AREA COUNTRIES NOT MEMBERS OF EC HAVE BEEN SALEABLE IN INVESTMENT CURRENCY MARKET (SUBJECT TO 25 PERCENT SURRENDER REQUIREMENT). THIS HAS GIVEN WINDFALL GAINS ON THAT PORTION OF DISINVESTMENT RECEIVING INVESTMENT CURRENCY PREMIUM. HENCEFORTH, ALL PROCEEDS OF SUCH DISINVESTMENT MUST NORMALLY BE SOLD IN THE OFFICIAL MARKET.

D. EXISTING REQUIREMENT THAT U.K. DIRECT INVESTORS ABROAD WOULD NORMALLY REPATRIATE NOT LESS THAN TWO-THIRDS PROFITS AFTER TAXES IS EXTENDED TO OVERSEAS STERLING AREA COUNTRIES.

5. LOOKING AHEAD, HEALEY CITED BENEFITS OF OIL SUPPLIES FROM THE NORTH SEA BUT STRESSED U.K. MUST NOT IMAGINE THIS WOULD BE THE ANSWER TO ALL ITS PROBLEMS. HOWEVER, PROVIDED THE U.K. TAKES ITS RIGHTFUL SHARE OF THE PROFITS IT IS BOUND TO BRING SUBSTANTIAL ADVANTAGE TO U.K. BALANCE OF PAYMENTS.

6. HEALEY ALSO SIGNED PROPOSED CHANGES IN TAXATION OF FOREIGN INCOME, IN LARGE MEASURE AIMED AT STOPPING AVOIDANCE OF TAX BY ARTIFICIAL DEVICES. TAXATION OF EARNINGS BY U.K. RESIDENTS FROM OVERSEAS EMPLOYMENT, TRADE, AND PROFESSION IS CURRENTLY ON A REMITTANCE BASIS. IT WILL BE CHANGED TO INCOME ARISING FROM OVERSEAS EMPLOYMENT, IRRESPECTIVE OF AMOUNT REMITTED. TAX ASSESSMENT WILL BE LIMITED TO 90 PERCENT OF FULL AMOUNT OF INCOME. SAME TREATMENT WILL APPLY TO PENSIONS FROM OVERSEAS RECEIVED BY U.K. RESIDENTS; THEY WILL PAY

ON FULL AMOUNT, SUBJECT TO 10 PERCENT REDUCTION.

7. SIMILAR PROPOSALS WILL BE INTRODUCED TO APPLY TO FOREIGNERS TEMPORARILY WORKING IN U.K. WHOSE EMPLOYER IS IDENT ABROAD. THEY WILL BE ASSESSED ON TAX ON HALF THEIR EARNINGS.

8. PROFITS OF OIL COMPANIES WERE CONSIDERED A SPECIAL PROBLEM, PARTICULARLY HOW TO ENSURE THAT PROFITS OF UNCLASSIFIED

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NORTH SEA OIL BEAR THEIR PROPER WEIGHT OF CORPORATION TAX, AND THAT OIL COMPANIES' ACCUMULATED LOSSES CANNOT BE SET AGAINST PROFITS OF CONTINENTAL SHELF. HEALEY WILL WANT TO CONSIDER ENTIRE QUESTION, INCLUDING VIEWS OF PREVIOUS GOVERNMENT TO ENSURE THAT PUBLIC DERIVES AN ADEQUATE SHARE OF VERY LARGE PROFITS FLOWING FROM CONTINENTAL SHELF AND TO REMEDY EXISTING SHORT-COMINGS IN TAX TREATMENT OF OIL COMPANIES.

9. COMMENT: EMBASSY'S INITIAL REACTION IS THAT INTERNATIONALLY, HEALEY'S FIRST BUDGET WAS AIMED AT SHOWING CONCERN TO REDRESS BALANCE OF PAYMENTS, ACT RESPONSIBLY

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INT-08 FEA-02 SCI-06 TAR-02 IO-14 DRC-01 /216 W

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FM AMEMBASSY LONDON
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IN WAY ACCEPTABLE TO INTERNATIONAL COMMUNITY. IT CONTAINS NO DIRECT RESTRICTIONS ON IMPORTS, AND RETALIATORY DANGERS OF THIS TYPE ACTION WERE CITED. NEED TO REDRESS THE NON-OIL PORTION OF THE BALANCE OF PAYMENTS, INCLUDING NEED TO PUT MORE DOMESTIC RESOURCES INTO EXPORTS WAS HIGHLIGHTED. HEALEY TRIED TO MAKE IT CLEAR TO THE WORLD THAT THE U.K. CAN FINANCE ITS DEFICIT, BUT THAT FOREIGN BORROWING AND NORTH SEA OIL ARE NOT PANACEAS. THIS MUCH SAID, HE POINTED OUT THAT "NATION'S RIGHTFUL SHARE" OF PROFITS FROM THE NORTH SEA ARE BOUND TO BRING SUBSTANTIAL ADVANTAGE TO BALANCE OF PAYMENTS.

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10. BY TIGHTENING EXCHANGE CONTROLS, HEALEY TOOK DIRECT ACTION TO MAKE BALANCE OF PAYMENTS SAVINGS IN A RELATIVELY NON-CONTROVERSIAL WAY. FOR PURPOSES OF EXCHANGE CONTROL, EC AND STERLING AREA COUNTRIES HAVE BEEN RELEGATED TO THE SAME MORE RESTRICTIVE BASIS AS THIRD COUNTRIES, INCLUDING THE U.S. MAJOR GRIPES, IF ANY, WOULD BE EXPECTED FROM THE EC AND OVERSEAS STERLING AREA COUNTRIES RATHER THAN FROM THE U.S. SOME OF PREVIOUS GOVERNMENTS CAPITAL LIBERALIZATION MEASURES TAKEN IN CONNECTION WITH EC MEMBERSHIP ARE THUS RESCINDED. THIS IS ALSO A FURTHER STEP IN THE REDUCTION IN THE IMPORTANCE OF THE OVERSEAS STERLING AREA. FOR U.K. EXCHANGE CONTROLS ON DIRECT AND PORTFOLIO INVESTMENT, THE ENTIRE WORLD IS NOW TREATED AS ONE. ONE STATED AIM IS TO EFFECT MEANS OF FINANCING OF THE OUTWARD INVESTMENT, BUT NOT THE INVESTMENT ITSELF.

11. NO SPECIFICS WERE GIVEN ON THE IMPLEMENTATION OR STATUS OF PERSONAL TAX CREDITS UNDER THE INDIVIDUAL TAX MEASURES CITED IN PARAS 6 AND 7 ABOVE. THEY SHOULD

BRING FORTH SCREAMS, PRESUMABLY INCLUDING SOME FROM U.S.
BUSINESSMEN IN THE U.K.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: GOVERNMENT BUDGET, SPEECHES, LOANS, CURRENCY SWAPS, BANKS
Control Number: n/a
Copy: SINGLE
Draft Date: 26 MAR 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974LONDON03830
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D740065-0776
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740315/aaaaanpr.tel
Line Count: 335
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators:
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags:
Review Date: 11 JUL 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <11 JUL 2002 by elbezefj>; APPROVED <17 JUL 2002 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: INTERNATIONAL ASPECTS OF CHANCELLOR HEALEY'S BUDGET SPEECH
TAGS: EFIN, UK, BANK OF ENGLAND, EEC, FRB, (HEALEY)
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005